

# **HTSUS 9802.00.40 and 9802.00.50 – ARTICLES EXPORTED FOR REPAIRS OR ALTERATIONS TECHNICAL INFORMATION FOR PRE-ASSESSMENT SURVEY (TIPS)**

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## **HTSUS 9802.00.40 and 9802.00.50 – ARTICLES EXPORTED FOR REPAIRS OR ALTERATIONS TECHNICAL INFORMATION FOR PRE-ASSESSMENT SURVEY (TIPS)**

### **PART 1 BACKGROUND**

The objective of this document is to provide guidance for performing a Pre-Assessment Survey (PAS) of the company's internal control for merchandise entered under in HTSUS 9802.00.40 and 9802.00.50 and evaluating the results.

Generally Accepted Government Auditing Standards require the PAS team to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing, and extent of tests to be performed.

The guidelines and terms in this document are based on *Assessing Internal Controls in Performance Audits*, GAO/OP- 4.1.4 - published by the United States General Accounting Office, Office of Policy, September 1990, and the American Institute of Certified Public Accountants *Statement on Auditing Standards No. 78*.

### **PART 2 HTSUS 9802.00.40 AND 9802.00.50 GUIDANCE**

HTSUS 9802.00.40 merchandise is merchandise that was exported to a foreign country for repairs or alterations pursuant to a warranty and returned to the U.S.

HTSUS 9802.00.50 merchandise is merchandise that was exported for repairs or alternations not covered under a warranty and returned to the U.S.

Regulations governing 9802.00.40 and 9802.00.50 are in 19 CFR Part 10.8(a) through (d). U.S. Note 3 of Subchapter II of Chapter 98 of the Harmonized Tariff of the United States (HTSUS) provides criteria for duty treatment of these articles. The articles, which can be of U.S. origin or foreign, are dutiable on the cost to the importer for the repairs/alterations or if free of charge, the value of the repairs/alternations.

The following conditions preclude the use of 9802.00.40 and 9802.00.50:

- The importer fails to identify the articles as being previously exported.
- The foreign operations caused the identity or HTSUS classification of the exported article to change.
- The foreign operations were limited to minor procedures, such as warehousing, repackaging, sorting, and testing not performed in conjunction with repairs or alterations.
- The exported articles were incomplete for their intended use prior to being exported and the foreign operation constitutes an intermediate processing operation.
- Drawback has been claimed on the exported articles.

### **2.1 EXAMPLES OF RED FLAGS**

The following examples of red flags are conditions that may indicate a potential problem in 9802.00.40/50:

- Company has insufficiently documented, poorly defined, or no internal control for claiming 9802.00.40/50. Examples:
  - ✓ Company does not monitor or interact with the broker on 9802.00.40/50 issues.
  - ✓ Company relies on one employee to handle 9802.00.40/50 issues, and there are poor or no management checks or balances over this employee.
- Company's import staff lacks knowledge of 9802.00.40/50 requirements.
- Company's import staff lacks the knowledge of cost accounting that is necessary to determine whether the value covers all costs and profit for repairs performed by related parties or under warranty, and to ensure that supporting cost records are retained and readily available.
- Company offers unreasonable explanations to Customs.
- Company fails to cooperate with or respond to Customs.
- Company has high turnover of people in key positions.
- Significant variances exist between the importer's data and Customs' data.
- Customs (e.g., import specialist, account manager, compliance measurement, prior audit, other profile information) shows a history of problems with 9802.00.40/50
- Company has many drawback claims.
- Company has poor internal control to ascertain that the part exported for repair is the same as the part re-imported (i.e., products without unique number as means of tracking such as serial number, lot number, etc.).
- Company does not have written repair contracts explaining how the repair cost of different components is determined.
- The Questionnaire indicated that the company does not have:
  - ✓ Procedures to verify repairer's declarations (see reasonable care – United States v. Golden Ship Trading Company, Joanne Wu and American Motorists Insurance Company, Slip Op. 01-7).
  - ✓ Procedures to review manufacturing operations performed at the foreign plant to determine whether such operations qualify for partial exemption.
  - ✓ Procedures to ensure that the foreign operations do not result in commercially different articles with new properties and characteristics.
  - ✓ Procedures to verify the cost or value of the repairs or alterations actually performed abroad. The cost should include all domestic and foreign articles furnished for the repairs or alterations, not including any of the expenses incurred in this country whether by way of engineering costs, preparation of plans or specifications, furnishing of tools or equipment for doing the repairs or alterations abroad, or otherwise."
- The value of the imports was based on estimated or standard costs.
- Company does not have warranty documentation for articles claimed as 9802.00.40.

Note: Foreign repairs are often performed by the related foreign factories that manufactured the products. When importer and foreign repair sites are related, or work was done under warranty, all elements of cost and profit, including overhead, general expenses and profit may **NOT** be included in the repair value. Consider that Transaction Value may not be acceptable if the repair value does not cover all costs and a reasonable profit.

## 2.2 EXAMPLES OF BEST PRACTICES

- Internal controls over 9802.00.40/50:
  - ✓ Are in writing;
  - ✓ Include procedures for monitoring and feedback; and

- ✓ Are monitored by management.
- One manager is ultimately responsible for control of the Import/Export Department, including 9802.00.40/50 matters. That manager has knowledge of Customs matters and the authority to ensure internal control procedures for imports are established and followed by all company departments.
- The Import Manager also has cost accounting knowledge, for control of imports from related parties or under warranty.
- Written internal control procedures assign duties and tasks to a position rather than a person.
- Company has good interdepartmental communication about 9802.00.40/50 matters.
- Company conducts and documents periodic reviews of 9802.00.40/50 matters, and uses the results to make corrections to entries and changes to their import operations as appropriate.
- Company has an export log with serial number, invoice number, and other pertinent information to track merchandise.
- Company maintains documentation indicating that foreign costs include all reportable elements.
- Company maintains documentation for foreign operations to ensure that proper repairs and alterations were actually made.
- Company maintains a log that identifies warranty and non-warranty costs.

## 2.3 EXAMPLES OF DOCUMENTS AND INFORMATION TO REVIEW

- Internal control policies and procedures.
- The company's response to the questionnaire.
- Interviews with company staff concerning actual procedures and internal control specific to 9802.00.40/50.
- Documentation that supports monitoring and verification of established and/or written internal control for 9802.00.40/50.
- Other documents supporting 9802.00.40/50 claims including:
  - ✓ Declaration from the person who performed the repairs/alternations.
  - ✓ Declaration by the owner, importer, consignee or agent having knowledge of the repair.
  - ✓ Export documents (invoices, bill of lading, etc.).
  - ✓ Bills of Materials and/or detailed breakdown of standard material costs.
  - ✓ Repair orders, purchase order, and/or contracts documenting the reason for exportation.
  - ✓ Warranty repair agreement.
  - ✓ Cost sheets from related parties or for repairs under warranty showing the elements of cost and profit for each product repaired.
  - ✓ Supporting labor cost records for products repaired.
  - ✓ Calculation and allocation worksheets for overhead, general expenses and profit for products repaired.
  - ✓ Accounting records.

## PART 3 RISK ASSESSMENT AND INTERNAL CONTROL GUIDANCE

PAS team judgment should be used to determine the type and amount of testing needed to evaluate how effective internal control is and whether there is sufficient risk to warrant proceeding to the Assessment Compliance Testing (ACT) process.

Using the chart and the guidelines below, determine through limited judgmental testing whether the company's internal controls are effective.

To determine the extensiveness of internal control testing, it is necessary to evaluate:

1. **Risk**, and
2. The **internal control** system, by determining if the controls are in operation, how the controls were applied, how consistently they are applied, and who applies them.

### 3.1 RISK

#### A. Preliminary Assessment of Risk

Before any audit work begins at the company the team should make a preliminary assessment of risk (PAR) using information obtained from Customs or publicly available information. The purpose of the PAR is to evaluate identified potential risks to Customs based on analytical reviews of Customs data and other Customs information. This review will identify areas of potential risk and eliminate some areas with insignificant risk. The PAR should be conducted using the form in Attachment 1 to the PAS Audit Program.

#### B. Evaluation of Risk Acceptability

After the audit work begins with the company the team will refine the assessment of risk. After all audit work has been completed the team will determine whether risk is acceptable or unacceptable using the PAS Audit Program as summarized in the following steps.

- Determine what activities pose a significant risk to Customs.
- Test the existence, effectiveness and implementation of internal control and determine if internal control is adequate to control risk.
- Using the results of the internal control review, develop an opinion whether risk is acceptable or unacceptable.

### 3.2 INTERNAL CONTROL

To evaluate the internal control system:

1. Consider the five components of internal control:
  - Control Environment.
  - Risk Assessment.
  - Control Activities.
  - Information and Communication.

- Monitoring
2. Review relevant Customs and company documents to identify and understand relevant internal control over 9802.00.40/50 (Examples of documents and information to review are listed above).
  3. Determine whether the company has established and follows procedures. Review:
    - Documentary evidence of the results of periodic internal control reviews/testing and corrective action implemented.
    - Documentary evidence of communication between the broker and company on 9802.00.40/50 issues, company testing of broker operations, and verification that the broker followed company instructions.
    - Company-specific rulings and evidence that they are followed.
    - Documentary evidence of intra-company communications to ensure that correct information is provided to Customs.
    - Training records and materials used to educate staff on 9802.00.40/50 issues including knowledge of cost accounting standards if foreign repair sites are related or repairs are performed under warranty.
    - Documentary evidence indicating that the company ensured that the merchandise was not advanced in value or improved in condition abroad.
    - Documentary evidence indicating that the company ensured that the imported merchandise was the same as the exported articles.
    - Documentary evidence, including repairer's declaration, of the type of repairs or alterations taking place.
    - Documentary evidence to support that the value of foreign repair includes all elements of cost and profit and that the records to support such costs are retained and readily available.
    - Documents such as cost sheets from related parties or for repairs under warranty, showing that the elements of cost and profit for each product repaired, included material, labor, overhead, general expenses and profit.
  4. Review written policies and procedures and interview applicable company personnel to complete appropriate sections of the Worksheet for Evaluating Internal Control (WEIC) for 9802.00.40 and 9802.00.50 in PART 4 of this document.

Note: The internal control assessment should include steps to:

- Identify and understand internal control.
- Determine what is already known about control effectiveness.
- Assess the adequacy of internal control design.
- Determine whether controls are implemented and effective.
- Determine whether transaction processes are documented.

### **3.3 EXTENSIVENESS OF AUDIT SAMPLE TESTS (TESTING LIMIT)**

The purpose of limited PAS testing is to take a survey in order to determine the necessity for and extent of substantive tests. In some circumstances, the PAS team may decide that it probably will not be able to form an opinion based on limited PAS testing. In that case, it may be necessary to proceed immediately to the ACT process. If the PAS team believes that it can form

an opinion based on limited PAS testing, it should test the appropriate number of controls and associated transactions using the table below. Tests may be appropriate for various areas below the overall 9802 level that will be reported on. For example, the company may import from various foreign entities and from various countries and tests may be designed for areas identified as the primary risks.

### Extensiveness of Audit Tests

PAR Level	+	Preliminary Review Internal Control	=	Extensiveness of Audit Test	Testing Limit
<b>High</b>		Weak Adequate Strong		High Moderate to High Low to Moderate	10-20
<b>Moderate</b>		Weak Adequate Strong		Moderate to High Moderate Low	5-15
<b>Low</b>		Weak Adequate Strong		Low to Moderate Low Very Low	1-10

Source: Adapted from *Assessing Internal Controls in Performance Audits*.  
Column titled "Testing Limit" reflects Customs test sizes.

### 3.4 EVALUATION OF PRE-ASSESSMENT SURVEY TESTING RESULTS

The following steps are guidance for determining the effectiveness of company's internal control over 9802.00.40 and 9802.00.50.

1. Complete the WEIC for 9802.00.40 and 9802.00.50 to determine whether risk is acceptable or unacceptable and to document why. Put the results of testing in perspective and evaluate confirmed weakness as a whole. The evaluation should consider the results of the internal control testing, problems identified in the profile, and/or concerns raised by the import specialist or account manager. The team must evaluate the PAS results based on the specific situations.
2. The following will help the PAS team determine whether conditions warrant proceeding to ACT:

#### Do not proceed to ACT if:

- Cost-benefit analysis warrants no further effort, (do not spend a significant amount of resources to identify a potential loss of revenue considered insignificant.) and
- The result of review indicated that the error was due to an isolated incident.
- If substantive tests necessary to determine a compliance rate or revenue loss can be performed quickly and without extensive effort, the team should immediately perform the substantive tests without proceeding to ACT.

#### Proceed to ACT if:

- The company does not have adequate internal control and the review indicated a material loss of revenue that cannot be quantified without statistical sampling or further review.
- The importer will not quantify the loss of revenue.
- The company refuses to take corrective action on systemic errors and it is necessary to calculate a compliance rate to evidence significant non-compliance.

Note: If substantive tests necessary to determine a compliance rate or revenue loss can be quickly performed without extensive effort, the team should immediately perform the substantive tests without proceeding to ACT.

3. Determine whether referrals should be made for enforcement action.

### 3.5 EXAMPLES

The following examples of situations that might be encountered under the PAS *are for clarification only*:

Example A: Situation in which the team would not proceed to ACT (Revenue)

#### Company's Policies and Procedures

The company's Customs Compliance Manual requires the purchasing department to obtain a declaration from the foreign company performing the repairs or alterations. The buyer submits the declaration to the company's Import Branch (a branch in the Import/Export Department) and provides assistance to the Branch in preparing the Importer's Declaration. The Import Branch in turn is responsible for submitting the declarations to the Customs broker with instructions to include them with the entry. The buyer is also responsible for conferring with the foreign companies to ensure that invoices separately identify each repair or alteration performed and include the cost or value of the repairs. The Manual further requires the Import Branch to maintain and have ready for submission, the foreign customs entry, foreign customs invoice, and bill of lading/airwaybill related to the export for repairs and/or alterations in case the U.S. Customs Service should request additional supporting documentation.

#### Monitoring Activities

The company's Import Branch conducts a cursory review of all entries filed by its broker. The individual reviewing the entry initials and dates the file indicating that the review was done. If an error is identified, the Company sends the broker a letter describing the type of error with instructions to correct the error. In addition, the company reconciles the export quantity to imported quantity on a monthly basis to ensure that materials returned after being exported for repairs/alterations do not exceed the quantity originally exported.

The Manual also requires the Import/Export Compliance Manager to conduct internal audits on a semi-annual basis. It requires the Manager to select 26 entries (one from each week in the six-month period) for detailed review. If the review discloses any entry to be substantially non-compliant, the Manager will check entries made 15 days' prior and 15 days after the date of the non-compliant entry. Within two weeks of completing the audit, the Manager is required to prepare a report with findings and recommendations and submit it to the Director of the Import/Export Department.



### Pre-Assessment Survey

To determine if the controls were working, the team:

- Interviewed employees in the Purchasing, the Import Branch, and the Import/Export Department to determine if they were familiar with the procedures established in the Customs Compliance Manual.
- Selected six entries from the entries reviewed by the Import/Export Compliance Manager (two for each month in a three month period) and:
  - ✓ Determined if the company had the Repairer and Importer's declarations on file.
  - ✓ Reviewed repair orders to determine the type of work to be conducted by the foreign company.
  - ✓ Determined whether the invoice identified each of the repairs or alterations performed on the merchandise and the cost of the same.
  - ✓ Compared the repair orders to the commercial invoices.
  - ✓ Determined whether the company maintained copies of the foreign customs entry, foreign customs invoice, bill of lading or airway.
- Selected four entries from the company's files for the most current month and:
  - ✓ Determined if the files contained employees' initials indicating that the entries had been reviewed by the Import/Export Department staff.
  - ✓ Determined if the company had the Repairer and Importer's declaration on file.
  - ✓ Reviewed repair orders to determine the type of work to be conducted by the foreign company.
  - ✓ Determined whether the invoice identified each of the repairs or alterations performed on the merchandise and the cost of the same.
  - ✓ Compared the repair orders to the commercial invoices.
  - ✓ Determined if the company maintained copies of the foreign customs entry, foreign customs invoice, bill of lading or airway.
- Selected a small sample of products from related vendors, and those repaired under warranty:
  - ✓ Compared cost sheets for the foreign repairs and other supporting records, as necessary, to determine whether the value included all costs plus profit.
  - ✓ Determined whether the repairs were actually made under warranty.
- Reviewed company correspondence with the Customs broker.
- Reviewed the last three monthly quantity reconciliations performed by the Import/Export Department.
- Reviewed the most current compliance report prepared by the Import/Export Compliance Manager.

The PAS indicated that the company failed to prepare and maintain repairer's declarations to support eligibility for 9802. The PAS team did not find any evidence that the Import/Export Department staff reviewed the entries. The company agreed with the PAS findings and was able to quantify the loss of revenue.

### Example B: Situation in which the team would not proceed to ACT (Compliance)

Same situation as Example A above, except the PAS team was able to verify that controls were in place and working effectively. Therefore, proceeding to ACT was not considered necessary.

### Example C: Situation in which the team would proceed to ACT (Revenue)

Same situation as Example A above, except the company was not able to quantify the loss of revenue caused by not being able to support 9802 eligibility. Therefore, proceeding to ACT was considered necessary.

**Example D: Situation in which the team would proceed to ACT (Compliance)**

The same situation as Example A above; however, it was found that the Import/Export Compliance Manager only reviews six entries semi-annually instead of 26 as called for in the company's Manual. The Import/Export Compliance Manager refused to follow the company's Manual saying it was too time consuming, and did not take other corrective actions to address this issue. Therefore, the PAS Team would proceed to ACT.

# **PART 4 WORKSHEET FOR EVALUATING INTERNAL CONTROL (WEIC) – HTSUS 9802.00.40 and 9802.00.50 (Articles Exported for Repairs or Alterations)**

**PURPOSE:** To determine whether 9802.00.40 and 9802.00.50 risk is acceptable.

The completion of this worksheet provides evidence that the five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communications, and Monitoring were evaluated.

During this phase of the process, an internal control review will be completed and factors for internal control related to an assessment of Risk Exposure including Internal Control Red Flags, Susceptibility, Management Support and Competent Personnel will be considered. The completion of this worksheet provides evidence that these factors were evaluated.

**All answers must be linked to supporting documentation.**

## **OBJECTIVES:**

Section 1 - Internal Control Questions	Consolidate information learned about internal control through interviews and document reviews to form a preliminary assessment of internal control before testing. For work paper reference column titled "Is Implementation of Control Supported by Documentation and/or Interviews," confirm that the control is implemented through: <ul style="list-style-type: none"> <li>Interviews and requesting evidence from the company and</li> <li>Reviews of documents that provide evidence that the company completed the activity.</li> </ul>
Section 2 - Preliminary Internal Control Assessment	Use information consolidated in Section 1 to make a preliminary assessment whether internal control is strong, adequate, weak or nonexistent.
Section 3 - Sample sizes	Use the Preliminary Assessment of Risk (PAR) Level and the Preliminary Internal Control Assessment to determine the sample size for each sample.
Section 4 - Results of Sample Testing	Use information in Section 4 to record the results of PAS testing to evaluate whether internal control is effective to provide reasonable assurance of compliance.
Section 5 - Risk Opinion	Use information in section 1-4 to record the PAS opinion that risk is acceptable or unacceptable

**Section 1 – Internal Control Questions**

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
1.	Does the company have formally documented internal control to assure that 9802.00.40/50 is correctly declared?					
2.	Does management approve written policies and procedures?					
3.	Does the company review and update written policies and procedures periodically?					
4.	Is one department/individual primarily responsible for ensuring compliance with 9802.00.40/50 requirements?					
5.	Do written procedures assign responsibilities to a position rather than a person?					
6.	Does the individual overseeing compliance with 9802.00.40/50 requirements have adequate knowledge and training and authority to ensure that internal control procedures for imports are established and followed by all departments?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
7.	Does the individual overseeing compliance have adequate cost accounting knowledge, if products are repaired by related vendors, or under warranty?					
8.	Are internal controls over 9802.00.40/50 periodically tested?					
9.	Were the results of the periodic internal control tests documented?					
10.	If weaknesses were found during internal control testing, were corrective actions implemented?					
11.	Does the company identify, analyze, and manage risks related to 9802.00.40 and 50?					
12.	Has the company identified any risks related to 9802.00.40 and 50 and implemented control mechanisms?					
13.	Does the company use the results of testing to correct its import declarations?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
14.	Do the company's procedures include a retention program for documents needed to support 9802.00.40/50 claims (e.g. importer's declarations, repairer's declarations, cost sheets and supporting financial documents from related parties and for warranty repairs, etc.)					
15.	Does the company have procedures in place to ensure that the true costs for material, labor, overhead, general expenses and profit were included in the value of repairs performed by related parties, and for warranty work, even if not payable on the part of the importer?					
16.	Does the company have good interdepartmental communication about 9802.00.40/50 matters?					
17.	Do written controls include specific procedures for monitoring eligibility with 9802.00.40/50 requirements?					
18.	Does the company have procedures to ensure that merchandise imported was the same as the merchandise exported?					

No.	Internal Control (IC)	Yes	No	Work Paper Reference		Comments
				IC Manual Page Number	Is Implementation of Control Supported by Documentation and/or Interviews?	
19.	Does the company have procedures in place to ensure the foreign operations did not cause the identity or HTSUS classification of the exported article to change?					
20.	Does the company have procedures in place to ensure that drawback was not previously claimed on exported articles?					
21.	Does the company provide adequate broker oversight?					
22.	List company-specific procedures and controls below (if applicable):					

## Section 2 - Preliminary Internal Control Assessment

Use information obtained in section 1 above to make a preliminary assessment of internal control as strong, adequate, weak, or nonexistent.

	Strong	Adequate	Weak	None*
Internal Control				

\* If the team concludes that the company does not have internal control, risk is not acceptable so proceed to Section 5 below.

## Section 3 – Sample Sizes

Use the matrix for determining Extensiveness of Audit Tests in section 3.3 of TIPS to determine the extensiveness of audit tests to confirm that internal control is effective. Multiple samples are possible. Samples and sample items should concentrate on risk.

Sample Area	PAR Level (High, Moderate, or Low)	Internal Control Level (Weak, Adequate, or Strong) From Section 2 Above	Testing Limit (1-20)

#### Section 4 - Results of Sample Testing

Use the results of sample testing to determine if internal control is effective.

Results of Testing	Yes or No
Is IC effective to provide reasonable assurance to preclude significant risk?	

#### Section 5 - Risk Opinion

Use the information developed in Sections 1-4 to record the PAS opinion that risk is acceptable or unacceptable.

Risk Opinion	Yes or No	Comments
Acceptable		

If risk is not acceptable the audit team may need to proceed to ACT or have company do quantification.